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RHHJJAA/JICPAC HONOLULU HI
RUEKJCS/SECDEF WASHINGTON DC
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C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 000543

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DEPT FOR EAP/TC

E.O. 12958: DECL: 02/16/2016

TAGS: EINV ETTC ECON CH TW
SUBJECT: UMC FINED, "ACTIVE MANAGEMENT" STILL NOT "CLEAR
MANAGEMENT" (C- AL5-01182)

REF: A. TAIPEI 8

¶B. TAIPEI 9
¶C. TAIPEI 55
¶D. TAIPEI 85
¶E. TAIPEI 220
¶F. TAIPEI 399
¶G. TAIPEI 511

Classified By: AIT Acting Director David J. Keegan, Reason 1.4 d

¶1. (C) Summary: Taiwan authorities fined United Microelectronics Corporation (UMC) NT\$ 5 million (about US\$ 155,000) for investing in He Jian, a PRC semiconductor manufacturer. However, Taiwan's Investment Commission appears to have left the door open for UMC to accept a stake in He Jian and legalize their relationship. Charges remain pending against former UMC executives. This action sends an unclear signal to Taiwan businesses, who won't know the real penalties for illegal investment in the PRC until a final decision is made on UMC's potential stake in He Jian. End summary.

Maximum Fine Imposed

¶2. (U) Taiwan authorities fined UMC, Taiwan's second largest semiconductor manufacturer, NT\$ 5 million (about US\$ 154,000) for investing in He Jian, a PRC chip foundry on February 15. The statement released by the Ministry of Economic Affairs' (MOEA) Investment Commission, which approves Taiwan investment in the PRC, indicated that the commission had decided that consulting services provided by UMC constituted illegal investment in the firm. UMC has acknowledged that such services were provided but argued that no funds were invested in the PRC and no technology was transferred illegally. The Investment Commission statement said that UMC assisted He Jian with factory sites and equipment planning, production capacity scheduling, account management, and its public listing. In addition, the statement indicated that UMC provided He Jian with solutions for production technology problems.

¶3. (SBU) According to the Investment Commission, NT\$ 5

million was the maximum fine that it could impose on UMC. Currently the maximum fine for this type of violation is NT\$ 25 million (US\$ 772,000), but at the time UMC helped establish He Jian the maximum was only NT\$ 5 million. (Comment: UMC's cooperation with He Jian has been ongoing. We suspect that a larger fine may have been possible. End comment.)

Door Still Open to Legalize Investment

¶ 14. (C) As the Investment Commission's statement noted, He Jian has offered to grant UMC a 15 percent stake in the PRC firm in exchange for the assistance UMC has provided. The face value of such a stake is US\$ 110 million. Some analysts have argued that the assistance UMC has provided UMC is worth much more. We previously reported (ref D) that UMC had submitted an application to the commission to accept the stake in He Jian. The head of Taiwan's Investment Commission, Executive Secretary Huang Chin-tan, recently clarified to AIT/T that to date UMC has not submitted a formal application. Rather, UMC has only informally asked the commission for advice on how it might legalize its relationship with He Jian and accept an equity stake as compensation for the assistance.

¶ 15. (C) Huang told us that if UMC pays this latest fine within six months, it will not face further penalties based on violations of investment restrictions due to the assistance it has provided. According to Huang, after paying the fine, UMC can submit an application to accept a stake in He Jian. However, he pointed out that if UMC accepts the stake without approval, it could face additional fines up to the current maximum level of NT\$ 25

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million.

¶ 16. (C) Huang noted that such an application would not be approved if the stake constituted investment that is still prohibited. Under Taiwan's current regulations, Taiwan firms can build 8-inch semiconductor manufacturing facilities in the PRC that produce chips with feature size no finer than 0.25 microns. He Jian currently produces chips with more advanced 0.18-micron technology and is working with other foreign partners on developing 0.13-micron technology. (Comment: From Huang's comments it appears that one possibility may be for He Jian to break out its less advanced technology into a separate company. Taiwan might then permit UMC to accept a stake in the company using less advanced technology. End comment.)

Charges against Executives Still Pending

¶ 17. (U) He Jian's offer to grant UMC a stake in the firm is relevant to the Hsinchu County Prosecutors Office January 9 indictment of former UMC Chairman Robert Tsao and former Vice Chairman John Hsuan for breach of trust (ref D). The two are accused of violating the interests of shareholders by providing assistance to a potential competitor without proper compensation. If UMC is not permitted to accept a stake in He Jian and its assistance goes uncompensated, then the interests of shareholders will clearly have been harmed. The charges against Tsao and Hsuan still await trial.

Mixed Signals

¶ 18. (C) The chairman of another major Taiwan manufacturer told us February 16 that this decision offers no definitive indication of the Chen Administration's policy on cross-Straits economic ties. He said that there could be completely different signals from the Chen Administration on the next case. He also noted that the Taiwan Investment

Commission has placed his company's applications for further investments in the Mainland on a watch list. He emphasized that he continues to receive approvals, but indicated that the new procedures are a little bit tighter than they were. Finally, this chairman noted that UMC had made this a very public case by publishing ads in the newspaper criticizing the government cross-Straight policies. He said that he and most Taiwan firms would have made every effort to quietly meet with Taiwan officials and resolve this issue behind the scenes.

UMC Moving Forward and Fighting Back

¶9. (U) The day after the Investment Commission announcement, UMC repurchased one billion shares in the firm to increase share value. The price of UMC's shares rose 6.8 percent in trading on the Taiwan Stock Exchange. The same day, Chairman Jackson Hu announced that UMC would appeal the Investment Commission decision.

Conflicting Forces at Work

¶10. (SBU) The decision announced against UMC is the product of two competing forces at work in Taiwan's cross-Straight investment policy. On one hand, the Taiwan government wants to crack down on companies that have flagrantly violated restrictions on investment in the PRC. This force is driven in large part by political calculations that led to Chen Shui-bian's announcement of the new "active management" policy after the DPP's disappointing performance in December's island-wide local elections. The desire to crack down on UMC was compounded by Robert Tsao forcing the issue into prominence on the pages of Taiwan dailies with advertisements that criticized the government's investment policies and its handling of UMC's

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case.

¶11. (C) On the other hand, Taiwan remains a place where officials and business leaders engage in a long-term balancing of benefits and costs often without resorting to explicit laws and regulations. The culture of the Ministry of Economic Affairs is based on seeking solutions that both government and business can live with often through discussions behind the scenes. This tendency is reinforced by UMC's economic and symbolic role in Taiwan as its second largest semiconductor firm and a major player in the global electronics industry.

Comment - Obey What?

¶12. (C) The conflict between these two forces has sent a confusing message to Taiwan businesses. The Investment Commission has publicized that it imposed the maximum fine on UMC. However, AIT/T suspects that much stronger action could have been taken particularly with regard to He Jian's offer to grant UMC a 15 percent stake. For a firm like UMC with US\$ 2.77 billion in revenue last year, a fine of US\$ 155,000 is a small price to pay in acquiring an investment worth at least US\$ 110 million. The actual value to UMC is much higher considering the head start a stake in He Jian, the number three foundry in the world's largest semiconductor market (ref F), would give UMC over its main rival Taiwan Semiconductor Manufacturing Company (TSMC), a firm which has painstakingly complied with Taiwan's restrictions on investment in the PRC.

¶13. (C) The outcome of charges against UMC's Tsao and Hsuan will help clarify for Taiwan businesses what penalties they face if they invest illegally in the PRC. However, the crucial test will be whether UMC is allowed to acquire the He Jian stake. We won't know the final answer to that

question for some time. UMC is likely to wait for the possibility that restrictions are loosened to permit investment in more advanced technology before submitting an application. At the very least, it will be several months before we see such liberalization; it might not occur under this administration at all (ref G). In the end, we believe that UMC's strategy will pay-off. In the meantime, the Taiwan government's message to business is "obey the rules, if you can figure out what they are." End comment.

KEEGAN